

July 6, 2000

MEMORANDUM FOR: Andrew M. Cuomo, Secretary, S

FROM: Susan Gaffney, Inspector General, G

SUBJECT: Puerto Rico Public Housing
Administration

This memorandum concerns HUD's failure to stop flagrant fraud, waste, and abuse in the operations of the Puerto Rico Public Housing Administration (PRPHA). HUD has failed to act despite i) my verbal advice to the Assistant Secretary of Public and Indian Housing in the fall of 1998, ii) my written notice in the Office of Inspector General semiannual Report to the Congress as of March 31, 1999, and iii) continuing disclosures, in my weekly reports to you since November 1998, of PRPHA-related indictments, guilty pleas, and serious internal control deficiencies.

This memorandum is submitted to you pursuant to Section 5(d) of the Inspector General Act of 1978, as amended. Section 5(d) provides as follows:

Each Inspector General shall report immediately to the head of the establishment involved whenever the Inspector General becomes aware of particularly serious or flagrant problems, abuses, or deficiencies relating to the administration of programs and operations of such establishment. The head of the establishment shall transmit any such report to the appropriate committees or subcommittees of Congress within seven calendar days, together with a report by the head of the establishment containing any comments such head deems appropriate.

Under separate cover, we are providing you with 20 copies of this memorandum (with Tabs), in order to facilitate your forwarding it to the Chairmen and Ranking Members of the following Committees and Subcommittees: Senate Committee on Appropriations; Senate Appropriations Subcommittee on Veterans Affairs, HUD, and Independent Agencies; Senate Committee on Banking, Housing, and Urban Affairs; Senate Banking, Housing, and Urban Affairs Subcommittee on Housing and Transportation; Senate Committee on Governmental Affairs; House Committee on Appropriations; House Appropriations Subcommittee on Veterans Affairs, HUD, and Independent Agencies; House Committee on Banking and Financial Services; House Banking and Financial Services Subcommittee on Housing and Community Opportunity; and House Committee on Government Reform.

The following paragraphs outline the situation at the PRPHA;

the PRPHA's reaction to OIG findings of fraud, waste, and abuse; HUD's response to the OIG findings; your announcement of additional funding for the PRPHA; and the OIG's recommendation for HUD action.

The Situation at the PRPHA

- PRPHA is the second largest public housing agency in the nation. In fiscal 1999, PRPHA's HUD-funded budget was about \$260.6 million for operating subsidy and the modernization program.
- In 1992, PRPHA was "privatized." Currently, PRPHA has 186 direct permanent positions and 120 contracted personnel with an employer-employee relationship. The function of these staff is principally to oversee contractors who carry out all the public housing project management functions.
- The U.S. Attorney for Puerto Rico, the Federal Bureau of Investigation, and the HUD OIG continue to pursue eight major public corruption cases involving employees of the PRPHA and/or contractors of the PRPHA. Since October 1998, 13 persons have been indicted on charges such as conspiracy to defraud, embezzlement, theft, kickbacks, and money laundering. To date, nine of these persons have pled guilty. Additional information on the indictments and guilty pleas is presented at Tab 1.
- On March 6, 2000, the HUD OIG issued an audit report detailing the weaknesses in PRPHA's procurement management that are allowing fraud, waste, and abuse to occur. Of the \$39 million in PRPHA procurements and other disbursements that the auditors looked at, they identified about \$21.8 million of ineligible costs and \$4.1 million in cost efficiencies. The audit report is presented at Tab 2.

PRPHA's Response to OIG Findings of Fraud, Waste, and Abuse

The PRPHA took the OIG's audit seriously enough to hire a private law firm to represent the PRPHA in dealings with the OIG. In its response to the OIG's draft report (which is presented in full at Appendix G of the final March 6, 2000 audit report), the law firm said that PRPHA "vehemently" disagreed with many aspects of the draft report, including many of the factual findings and recommendations, and claimed that the draft report failed to recognize "efforts already in place to improve operations."

Notably, the PRPHA Administrator, who was appointed in December 1997, had previously notified HUD that he had taken steps to correct deficiencies in the procurement area. In a letter dated September 3, 1998, the Administrator took credit for strict enforcement of procurement requirements by the procurement office, sufficient records to show the procurement history, and analysis

for each procurement. In our recent audit, we found that these areas were still deficient.

In responding to recommendations in the OIG's draft report, the law firm further stated: "PRPHA is particularly concerned because the OIG's recommendations are clearly overboard. If the OIG's recommendations are implemented, two years of resources, time and money which have gone into improving the agency will be wasted.

This will result in more confusion and delays which will cause the type of waste, fraud and abuse of which the OIG complains. Moreover, there is no evidence that more HUD oversight or a reconfiguration of the agency will improve its operation."

HUD's Response to the OIG Findings of Fraud, Waste, and Abuse

In its June 15, 2000 response to the OIG audit report (see Tab 3), HUD said it would deal with the audit findings concerning ineligible costs over the next 12 months. As to the systemic weaknesses in PRPHA procurement management, HUD proposed i) hiring contractors with expertise in procurement; ii) assembling a team consisting of the contractors and HUD staff to assess PRPHA's procurement system; iii) simultaneously asking the PRPHA to provide a report on the improvements it has made in its procurement operations; then iv) developing an 18 month technical assistance plan.

The lack of urgency in these plans is palpable. It is also shocking, given the continuing revelations of corruption at PRPHA.

Moreover, the plans don't make sense. Why does HUD need another assessment of the PRPHA procurement system, right on the heels of a comprehensive OIG audit, which followed numerous other reports by the OIG, Independent Public Accountants, and HUD pointing out the same procurement problems? And why does HUD think an 18 month technical assistance plan will be effective when a similar approach (a 2 year Memorandum of Agreement between HUD and PRPHA, signed in December 1996) was notoriously unsuccessful? See Tab 4 for the OIG's report on results obtained under the December 1996 Memorandum of Agreement.

Your Announcement of Additional Funding for PRPHA

On June 7, 2000, HUD issued a press release announcing that "U.S. Housing and Urban Development Secretary Andrew Cuomo and Governor Pedro Rossello of Puerto Rico today signed an agreement that will create a new relationship between HUD and Puerto Rico and benefit all the island's public housing residents. Under the agreement, HUD will provide an estimated \$130 million in additional funds to benefit the island's public housing residents over the next four years, along with technical assistance to ensure that the funds are spent effectively and appropriately." The press release is appended at Tab 5.

The San Juan newspaper El Nueva Dia reported on this agreement in an article titled (as translated into English) Fraud Does Not Provoke Penalties (Tab 6). According to the article, you said that HUD would not penalize Puerto Rico for the fraud at PRPHA, and you further explained that providing the additional funding and dealing with the fraud were the governmental equivalent of walking and chewing gum at the same time.

The problem is that the only part of the press release that seems to relate to dealing with the fraud is "Technical Assistance: HUD will provide more than \$200,000 in technical assistance to improve PRPHA's management, accounting and data collection." This approach appears consistent with HUD's response to the OIG audit report, and is objectionable for the same reasons.

Moreover, it is doubtful that additional funding is the key to PRPHA's management problems: as of June 1999, for instance, PRPHA had active HUD grants, including operating subsidy, of \$974.2 million, of which it had expended only \$339.2 million. Further, HUD has already tried the technical assistance approach: in October 1995, HUD's central office contracted with a firm to provide the PRPHA technical assistance, including creation of a central procurement unit and development of a procurement manual; as of March 31, 1998, HUD had paid \$987,493 for these technical services. PRPHA later contracted with an affiliate firm to provide similar technical assistance services and oversee the PRPHA's modernization program; as of September 21, 1999, PRPHA had paid \$4,399, 537 for these services.

OIG's Recommendation for HUD Action

The confluence of OIG audit and investigative work has laid out for us both the extensive corruption at PRPHA and the lack of internal controls that is enabling the corruption. This situation demands immediate, decisive action by HUD.

As detailed above, past attempts at improvement through strengthened HUD oversight, corrective action plans/memoranda of agreement, and technical assistance have not been successful. Against this background--and given the PRPHA's resistance to the audit report suggestion that the PRPHA be broken into smaller, more manageable housing authorities--we recommend that you look to Section 6(j)(3)(A) of the United States Housing Act of 1937, as amended. This Section provides you with four remedies in cases when "Notwithstanding any other provision of law or of any contract for contributions,...the occurrence of events or conditions...constitute a substantial default by a public housing agency with respect to the covenants or conditions to which the public housing agency is subject...." Among the four remedies provided for in this Section, the second--petition for the appointment of a judicial receiver--appears the most appropriate for PRPHA.